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No. 80-2143

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

Transcontinental Gas Pipe Line Corporation,
Petitioner,

v.

Federal Energy Regulatory Commission

ON CROSS-PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Brief For N.C. Natural, *et al.* In Opposition

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QUESTIONS PRESENTED

1. Whether the Federal Energy Regulatory Commission may require a natural gas company to demonstrate that the rate increases which such company has sought are "just and reasonable" under the Natural Gas Act, and, where the company has failed to carry this burden of persuasion, order the company to refund the portion of the increased rates found not justified.
2. Whether the Commission may honor provisions in a prior Commission-approved rate settlement agreement specifically stating that neither the Commission nor any other parties to such settlement will be bound in future rate cases by matters settled therein.

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North Carolina Natural Gas Corporation, Public Service Company of North Carolina, Inc., and Piedmont Natural Gas Company, Inc. (N.C. Natural, *et al.*)[1] hereby jointly submit their Brief In Opposition to the cross-petition filed in this docket on June 17, 1981 by Transcontinental Gas Pipe Line Corporation (Transco).

OPINIONS BELOW

The opinion of the Court of Appeals (FERC Pet. App. A, pp. 1a-27a)[2] is reported at 642 F.2d 1335. The orders of

[1]In accord with Rule 28.1, N.C. Natural, *et al.* state that they are corporations which have no parent companies, but which have the following subsidiaries and affiliates: Carolina Energy Company, Inc.; NCNG Exploration Corporation; Piedmont Exploration Company, Inc.; Tar Heel Energy Corporation.

[2]Copies of the opinion and orders of the court below and the pertinent statutory provisions appear in the Appendix to the Petition for a Writ of Certiorari filed on May 18, 1981 by the Federal Energy Regulatory Commission in No. 80-1937.

the Federal Energy Regulatory Commission (Commission)[3] which are pertinent to Transco's cross-petition are not reported and appear in Apendices A and B to Transco's cross-petition, at pp. 1a-2a and p. 3a, respectively.

JURISDICTION

The judgment of the Court of Appeals was entered on September 24, 1980. Various timely petitions for rehearing and suggestions for rehearing *en banc* filed by, *inter alia*, Transco were denied on December 18, 1980, with the exception of the replacement of one paragraph in the Court of Appeals' opinion. By orders issued March 13, March 18, and April 16, 1981, the Chief Justice extended the time for filing petitions for a writ of certiorari to and including May 17, 1981. On Monday, May 18, 1981, the Commission, the North Carolina Utilities Commission (NCUC), and N.C. Natural, *et al.* petitioned this Court (in Nos. 80-1937, *et seq.*) for writs of certiorari as to "cost allocation" issue in this case. Transco's cross-petition as to the other issue of "rate of return" was filed June 17, 1981 pursuant to Rule 19.5 of this Court's Rules. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. §717r(b).

STATUTES INVOLVED

Sections 4 and 5(a) of the Natural Gas Act, 15 U.S.C. §§717c and 717d, set out in FERC Pet. App. I, at pp. 63a-65a.

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[3]Under the Department of Energy Organization Act of 1977, 42 U.S.C. §§7101, 7172(a)(1)(B), the Federal Energy Regulatory Commission succeeded (in October of 1977) to most of the functions and responsibilities of the former Federal Power Commission under the Natural Gas Act. The term "Commission" herein refers to either the Federal Energy Regulatory Commission or the Federal Power Commission, as appropriate.

STATEMENT OF THE CASE

The Court of Appeals' opinion below reviewed the Commission's determination as to two issues regarding a wholesale rate increase filed with the Commission under Section 4 of the Natural Gas Act (Act) by Transco, a major natural gas pipeline system serving the eastern seaboard of the United States. The Commission (in No. 80-1937), NCUC (in No. 80-1938) and N.C. Natural, *et al.*[4] (in No. 80-1939) have petitioned this Court for certiorari only as to the D.C. Circuit's reversal, without remand, of the Commission's determination of the proper cost allocation to be reflected in Transco's increased rates. Transco now seeks in its cross-petition review also of the Court of Appeals' affirmance of the Commission's determination of the proper rate of return to be reflected in Transco's increased rates.

A. Statutory Framework

Section 4(d) of the Act requires that a natural gas company seeking to increase its interstate wholesale rates file new rate schedules with the Commission, as Transco did in its rate filing here at issue (FERC Pet. App. I, pp. 63a-65a, 15 U.S.C. §717c(d)). Under Section 4(e), the Commission may suspend the effectiveness of such new rates for up to five months, and enter upon a hearing concerning the *lawfulness* of the new rates. Section 4(a) of the Act declares that "[a]ll rates and charges [of] any natural gas company . . . shall be just and

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[4]N.C. Natural, *et al.* are natural gas distributing companies which purchase natural gas from Transco and resell such gas to residential, commercial and industrial consumers within the States of North Carolina and South Carolina. N.C. Natural, *et al.* actively participate on a regular basis in Transco's wholesale rate increase proceedings at the Commission.

reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful," and Section 4(b) declares that "[n]o natural gas company shall . . . (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges . . . or any other respect, either as between localities or as between classes of service" (FERC Pet.App. I, p. 63a, 15 U.S.C. §717c(a), (b)). At the end of the suspension period, the new increased rates may be collected, but such collection is subject to the hearing and a decision, in which the Commission may order the natural gas company "to refund, with interest, the portion of such increased rates or charges by [the Commission's] decision found not justified" (FERC Pet. App. I, p. 64a, 15 U.S.C. §717c(e)). Further, "[a]t any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural gas company..." (FERC Pet. App. I, p. 64a-65a, 15 U.S.C. §717c(e)).

Section 5(a) of the Act permits the Commission to investigate rates already in effect, providing that "[w]henever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State Commission or gas distributing company, shall find that any rate [or] charge . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate [or] charge to be thereafter observed and in force, and shall fix the same by order***" (FERC Pet.App. I, p. 65a, 15 U.S.C. §717d(a)).

B. The Commission Orders

This proceeding began on July 30, 1976, when Transco filed with the Commission pursuant to Section 4 of the Act a general wholesale rate increase wherein Transco

sought, *inter alia*, to increase its rates in each of its three geographical sales rate zones.[5] The Commission suspended these increased rates for the full statutory period, permitting them thereafter to become effective, subject to refund, under Section 4(e) of the Act.

Transco's increased rates reflected numerous changes in claimed costs and in the proportional allocations of such costs to its various rate schedules, including (1) an increase in Transco's claimed rate of return on equity capital from 14.75 percent to 17.00 percent, and (2) an allocation of transmission costs which resulted in a greater percentage increase to the rates in Zones 1 and 2 than to the rates in Zone 3. Ultimately, virtually all of the many issues as to the increased rates were resolved by a Commission-approved settlement. However, the two issues of the rate of return and the cost allocation reflected in the increased rates were among those reserved for separate, phased hearings and decision.

In the rate of return hearing, Transco sought to carry its burden under Section 4 of the Act to demonstrate the justness and reasonableness of its increased rates reflecting its claimed rate of return on its equity of 17.00 percent. The Commission staff witness introduced evidence in support of an equity return of 14.00 percent, somewhat below the equity return reflected in Transco's prior-existing rates, which rates had been the product of past rate settlements which had resolved numerous issues (including cost allocation) in prior rate cases. However, those past settlements only resolved such issues for the limited time periods to which those

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[5]Transco's pipeline system extends from the gas production areas in Texas and Louisiana through rate Zone 1 (the states of Mississippi, Alabama and Georgia), Zone 2 (South Carolina, North Carolina, Virginia and the District of Columbia), and Zone 3 (Pennsylvania and New York).

settlements were applicable. On February 3, 1978, the Administrative Law Judge (ALJ) issued an initial decision, holding that Transco had failed to justify an equity return of 17.00 percent, and adopted the Commission staff witness' recommendation that such return should be 14.00 percent. The ALJ rejected Transco's argument that the Commission was powerless to reduce the rate of return the company had achieved through prior limited-term settlements, except prospectively, after a full Section 5(a) investigation in which the Commission bore the burden of proof (Transco Cross-petition, App. C, p. 12a). Transco appealed the ALJ's decision on rate of return to the Commission, and on August 30, 1979, the Commission affirmed and adopted the decision of the ALJ (Transco Cross-petition, App. A, pp. 1a-2a).

As discussed in greater detail in N.C. Natural, *et al.*'s petition in No. 80-1939 (pp. 7-9), the Commission had issued on August 5, 1979 its Opinion No. 59 in which the Commission determined that Transco's increased rates were not just and reasonable in that such increased rates reflected a cost allocation which did not follow any recognized *method* of cost allocation but simply plugged into the rates certain cents-per-Mcf zone rate level differentials which had been reflected in prior rates negotiated in a 1962 rate settlement. The Commission found that "no adequate or proper basis had been shown to justify the continued application of [the] previously negotiated settlement rate differentials," (FERC App. F, p. 39a), as this procedure unfairly burdened Zone 1 and 2 customers with an increasingly disparate portion of Transco's transmission costs. The Commission determined that neither Transco, nor the supporters of the cost allocation reflected in Transco's increased rates had demonstrated that such rates were in this respect just and reasonable. The Commission ordered that Transco reflect in its

increased rates the well recognized Mcf-mile method of cost allocation, so that there would be "a proper apportionment of cost responsibility between and among Transco's customers" (FERC App. F, p. 39a).

C. The Opinion Below

Transco appealed the Commission's rate of return order, and certain Zone 3 distributor customers appealed the Commission's decision on the cost allocation issue, and the orders were reviewed together in the Court of Appeals.

On September 24, 1980, the D.C. Circuit reversed, without remand, the Commission's decision that the cost allocation reflected in Transco's increased rates had not been justified and its determination of the proper cost allocation to be reflected in such rates. The D.C. Circuit decided that before the Commission may pass upon the cost allocation reflected in Transco's increased rates, the Commission must undertake an investigation pursuant to Section 5(a) of the Act. In such an investigation, the Commission would bear the burden of persuasion, and the Commission's decision could only be applied prospectively and not retrospectively through refunds under Section 4(e) of the Act.

However, while reversing, without remand, the Commission's determination of the proper cost allocation, to be reflected in Transco's increased rates, the Court of Appeals affirmed the Commission's determination of the proper rate of return to be reflected in the increased rates. The Court of Appeals thus affirmed the Commission's finding that Transco had failed to meet its burden under Section 4 of the Act to demonstrate that its increased rates reflecting its claimed rate of return were justified, and the Commission's retroactive application of its decision (*i.e.*, the Commission's order that Transco must

recalculate its rates as they had been collected subject to refund, to reflect a lower rate of return and must make refunds of the excess revenues that had been collected under such rates).

REASONS FOR DENYING THE WRIT AS TO THE RATE OF RETURN ISSUE

Although N.C. Natural, *et al.* agree with Transco that the D.C. Circuit's rationale in its review of the transmission cost allocation determination is in fact totally inconsistent with the D.C. Circuit's affirmance of the Commission's rate of return determination, Transco's proposed resolution of this inconsistency is perversely to render *both* of the Court's decisions wrong. Instead of proposing to resolve the inconsistency by correcting the decision as to cost allocation, Transco proposes to *extend and compound* the Court of Appeals' error as to its novel interpretation of Sections 4 and 5 of the Act. This proposal would require an entirely inappropriate reversal (perhaps also without remand) of the Commission's rate of return determination.

The Court of Appeals' decision as to rate of return need not be reviewed by this Court because that decision is essentially correct. As discussed in N.C. Natural, *et al.*'s petition for certiorari as to the cost allocation issue (pp. 12-15), Transco filed *increased rates* with the Commission under Section 4(d) of the Act, and the levels of these increased rates necessarily reflected a myriad of ratemaking components, including, (1) Transco's claimed rate of return of 17.00 percent, and (2) Transco's proposed allocation of transmission costs, which increased rates in Zones 1 and 2 to a proportionally greater extent than in Zone 3. The Court of Appeals properly affirmed the Commission's decision that Transco had failed to carry its burden of persuasion that the claimed rate of return was justified, and the

Commission's order directing Transco to make refunds related thereto. Clearly, these actions were taken by the Commission under express powers granted by Congress in Section 4 of the Act. Transco's contention that the Commission does not have the power under Section 4 of the Act to suspend Transco's new increased rates and, after hearing, order full refunds with regard to the rate of return reflected therein, is totally untenable, and such contention is in no way aided by the D.C. Circuit's similar contention with regard to the cost allocation reflected in such rates. Both contentions simply fly in the face of the plain language of Section 4 of the Act.

The central error in Transco's argument, as well as in the D.C. Circuit's decision as to cost allocation, is found in Transco's repeated claim that the Act is concerned with so-called rate "components". Transco urges that even where a company has filed increased rates under Section 4 of the Act, the Commission is powerless to change the prior-existing "components" of these increased rates except prospectively, after a full Section 5 investigation in which the Commission bears the burden of proof (Transco Cross-petition, e.g., pp. 9-10). By "components", Transco presumably refers to those elements of cost which are reflected in an increased rate in "building block" fashion in the ratemaking process (including, among many other elements reflected in such increased rate, the elements of rate of return and cost allocation as discussed in N.C. Natural, *et al.*'s petition (pp. 12-13)). However, neither Section 4 nor Section 5, nor any other section of the Act makes mention of anything even vaguely resembling a rate "component". The Act speaks quite unambiguously of increased *"rates and charges"*, not *"components"* thereof (FERC Pet.,App. I, p. 64a):

> (e) Whenever any such new [rate] schedule is filed the Commission shall have authority,** to enter upon a hearing concerning the lawfulness of such *rate, charge,* classification or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such *rate, charge,* classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the *rate, charge,* classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective.** Where *increased rates or charges* are thus made effective, the Commission may,** upon completion of the hearing and decision, . . . order such natural-gas company to refund, with interest, the *portion of such increased rates or charges* by its decision found not justified. (Emphasis added)

Thus, when a pipeline *increases its rates,* as Transco did in this case, and regardless of the rate of return, cost allocation or other rate "components" reflected therein, the Commission has the power, clearly stated under the Act, to (1) suspend the effectiveness of those *increased* rates, (2) hold a hearing thereon, and (3) order refunds of the portion of the *increased rates* found unjustified. That is precisely what the Commission did as to both the rate of return and cost allocation reflected in

Transco's *increased rates* in this case, except that the Commission, in its discretion under Section 4, declined to order refunds of that portion of the increased Zone 1 and 2 rates found not justified as a result of the misallocation of costs reflected in those rates (FERC Pet. App. F, pp. 50a-52a).

Although N.C. Natural, *et al.* agree with Transco that the D.C. Circuit's opinion is not a model of clarity, it must be assumed that that Court believed that the Commission was correct in deciding the rate of return issue under Section 4. Otherwise, under the D.C. Circuit's theory of the meaning of Sections 4 and 5, expressed in the cost allocation section of its opinion, the Court would have to have reversed, rather than affirmed, the Commission on rate of return. Under the D.C. Circuit's theory, the Commission would have had no power under Section 4 of the Act to order the refunds of that portion of the revenues previously collected under the increased rates related to the difference between the 14.75 percent equity return reflected in Transco's prior-existing rates and the 14.00 percent adopted by the Commission.

Further, in its discussion of burden of persuasion, the Court of Appeals seemed to recognize that the Commission in the case at bar did not have this burden, as the Commission clearly would have had under Section 5 (FERC Pet. App. A, p. 24a):

> [W]e conclude that the Commission is not obliged to bear the burden of proving a change resulting from higher rates unjust. It need only conclude that the petitioner has failed to carry its burden of proof.

Nor is the fact that Transco's rate of return and cost allocations have been the subject of prior Commission-approved settlements in any way controlling as to the resolution of the proper rate of

return and cost allocation to be reflected in the rates in this case (Transco's Cross-petition, e.g., p. 12). Those settlements specifically provided that neither the Commission nor any other parties were to be bound in future rate proceedings by the settled matters therein.[6] Although, as pointed out in N.C. Natural, *et al.*'s petition in No. 80-1939 (pp. 19-26), the Court of Appeals ignored these non-binding provisions of the Commission-approved settlements with regard to the cost allocation issue, the Court of Appeals' affirmance of the Commission as to rate of return was *not* inconsistent with those provisions.[7]

It is therefore *not* the rate of return decision of the Court of Appeals which requires review, as that decision, unlike the Court of Apeals' decision as to cost allocation, is not in conflict with either the decisions of

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[6]N.C. Natural, *et al.* would note that the Commission in such settlements did not find either the prior rate of return or the prior cost allocation "just or reasonable" under the Act, in the sense of a finding made after full litigation of these issues, as apparently erroneously believed by the Court of Appeals (FERC Pet. App. A, p. 25a). These were approved only as part of the reasonable over-all settlements "in the public interest". *E.g., Transcontinental Gas Pipe Line Corp.*, 54 FPC 2150, 2155 (1975).

[7]As to Transco's further claim that the Court of Appeals failed to review properly the evidence as to rate of return, this is indeed an ironic contention in the context of Transco's basic concern as to the inconsistency of the Court of Appeals' decision as between the rate of return and cost allocation issues. As to the rate of return issue, that Court reviewed and discussed the evidence on all *sides* of the issue, including Transco's evidence. However, as to the cost allocation issue, the D.C. Circuit *ignored* the evidence supporting the Mcf-mile method adopted by the Commission; the D.C. Circuit discussed only the evidence which that Court believed supported the cost allocation which that Court determined was superior and which that Court imposed, without remand, on the Commission.

the Court or the decisions of other Federal Courts of Appeals.[8] *E.g. FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962); *Kansas-Nebraska Natural Gas Co.* v. *FPC*, 534 F.2d 227 (10th Cir. 1976).

However, Transco's cross-petition as to the rate of return issue does highlight the dangers of the D.C. Circuit's novel interpretations of the Act in the cost allocation portion of its decision. As discussed in N.C. Natural, *et al.*'s petition (pp. 13-15), the Court of Appeals' interpretation virtually would require the total nullification of the powers Congress specifically gave to the Commission, in plain words in Section 4 of the Act, to review fully a pipeline's increased rates. The Court of Appeals' interpretation would result necessarily in the Commission being helpless to change *any* so-called rate "component" which could be considered to have been in some way reflected in prior rates, except *prospectively* after a hearing in which the *Commission* bears the burden of proof. This would permit regulated companies in effect to ratchet upwards their rates by only proposing changes in those rate components which would tend to *raise* the rates, while leaving untouched those components which would tend to lower the rates (see N.C. Natural, *et al.'s* Petition, pp. 13-15). It is obvious that this was never contemplated by Congress, and is totally contrary to this Court's thorough discussion in *Tennessee Gas Transmission, supra,* of the risks borne by companies filing for increased rates under Section 4.

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[8]Transco's citation of this Court's decision in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956) is totally inapposite. That case involved only the question of whether a pipeline company selling gas to a distributing company *under a fixed rate contract* "may, without the consent of the distributing company, change the rate specified in the contract simply by filing a new rate schedule" with the Commission under Section 4 (350 U.S. at 333-4). This Court held that such a filing was a nullity under

CONCLUSION

The cross-petition for a writ of certiorari as to the rate of return issue should be denied.

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Section 4, but Transco's Section 4 filing herein was not contrary to any such fixed rate contract, nor was there any question raised as to Transco's right unilaterally to increase its rates. Only the Court of Appeals' decision to give the prior-existing cost allocation procedures precedential effect was violative of a contract (*i.e.* the prior Commission-approved rate settlement agreements, discussed *supra*).